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THE BIG SECRET ON WALL STREET

# Cashing In at the Courthouse

- ✘ Call in the Fixer to Right Corporate Wrongs
- ✘ Small Losses, Big Wins: Venture Capitalists of the Legal World

FROM THE DESK OF PORTER STANSBERRY

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## Cashing In at the Courthouse

### Call in the Fixer to Right Corporate Wrongs Small Losses, Big Wins: Venture Capitalists of the Legal World

Charlotte and Julian Savage couldn't drink their own tap water anymore.

The elderly North Carolina couple once operated a small but thriving farm. But in the early 1990s, a Smithfield Foods pork-processing plant came to town... and a cocktail of pig poop, rotten meat, and toxic chemicals started flowing downhill into the Savages' well water and through their bathtubs and kitchen spigots. "I try not to drink it," Charlotte said. "We mostly just drink drinks, sodas and things."

Six inches deep in Smithfield runoff, Charlotte and Julian's farm crops eventually withered and died. By 2006, when *Rolling Stone* magazine interviewed them, the couple were hiding indoors most of the time to avoid the downwind factory smell, which had knocked Julian unconscious in their front yard one day.

Julian's take on Smithfield's chemicals was simple: "(Y)ou go out and smell it one time and your ass is gone."

We've all heard horror stories about what goes into the hot dogs. And Virginia-based Smithfield Foods – the world's biggest pork producer, which processes over 18 million pigs a year for customers in 40 countries – generates a lot of hot dogs and a *whole* lot of horror stories.

In addition to its waste-filled drainage pools (euphemistically termed "lagoons"), Smithfield is frequently in the crosshairs for animal cruelty. Pigs don't have easy lives *or* deaths at the pork factory... and undercover activists document everything from unsanitary birthing pens to "gas chambers" that slowly suffocate pigs before slaughter.

As I (Porter) have written before, [I love meat](#). I *don't* love pig torture or toxic waste. (And judging from a spate of high-profile lawsuits, settlements, and pork-plant closures in recent years, other folks feel the same way.) But abused sows and chemical-soaked farmland aren't the whole story at Smithfield Foods.

Smithfield (and many other Big Pork stalwarts) have a secret, life-saving side gig... one that squealing activists conveniently ignore.

I'm willing to bet many PETA (People for the Ethical Treatment of Animals) folks have never visited this unobtrusive office-park-style building near Cincinnati, Ohio...



This is Smithfield BioScience, a lab that repurposes extra pig parts (the kind that are too gross even to make it into hot dogs) to try to save human lives.

Pig glands, mucosa, skin, organs, and tissues (known as “offal,” or refuse) make for bad bacon, but good medicine. All told, around 20 vital medical products come from pigs – which are genetically closer to people than many of us would like to acknowledge.

In its modest Ohio lab, Smithfield processes pigs’ intestinal mucus to create the life-saving anticoagulant heparin... harvests an effective arthritis treatment from piggy pituitary glands... peels off pigskin to use as wound dressings... and pops out healthy pig heart valves to replace faulty human ones. Johnsonville, the largest sausage producer in the United States, runs an in-house medical lab, too. So do a score of other major hog farmers.

Turns out, Big Pork isn’t so “offal” after all.

### **That’ll Do, Pig**

This story starts with the battle for the heart and soul of the American pig – a battle for the heart valve, anyway. And most importantly, the “Fixer” who stepped in and restored justice.

You likely know someone with a pig-heart-valve replacement. Pig valves work better than mechanical valves for many older heart-disease patients, because the organic tissue means patients don’t have to take side-effect-heavy blood thinners like warfarin.

The implant procedure, known as TAVR (transcatheter aortic valve replacement) has been around since the late 1960s, and hasn’t changed much since then. The pig valve... sourced from places like Smithfield Foods... is painstakingly sewn onto a round framework, snaked up through the femoral artery via catheter, and then inflated in place once it reaches the right spot.



The trouble was, for many years, once TAVR valves reached Destination Heart, they inflated *instantly*, like an umbrella with a broken spring. There was no adjustment, no second chance – just a “pop” and a prayer. If the valve didn’t unfurl correctly, the patient faced instant complications, and possibly open-heart surgery (which the TAVR procedure aimed to avoid in the first place).

That’s the problem that Colibri Heart Valve, LLC, a small, private Colorado research company, set out to solve in the early 2000s. In 2002, Colibri filed several original patent applications for a “controlled release” mechanism that would let doctors gradually insert and adjust the pig valve.

And then, mega medical-device corporation Medtronic stole their idea.

Sometime in 2014, Medtronic employees attended a Colibri presentation that included slides about the proprietary controlled-release mechanism. The Medtronic crew signed a non-disclosure agreement, but apparently took great notes.

Lo and behold... later that year, Medtronic came out with a TAVR controlled-release system called CoreValve. It worked the same way as Colibri’s, and the language used to describe it came straight out of Colibri’s playbook. The invention netted Medtronic billions of dollars... and Colibri got nothing.

It was a cut-and-dry patent-infringement lawsuit, but Colibri didn’t have the money to sue. What could a tiny private company do against a \$31 billion publicly traded biotech powerhouse?

The only thing they *could* do: They called the Fixer.

The Fixer is the leading global provider of *litigation financing*... a large company that funds lawsuits and then, when it wins, takes a cut of the payout. You might think this sounds like the Mafia, and you’re not wrong. But it’s an extremely effective business model.

Think of it as the venture-capital approach to lawsuits. Like venture capital companies, which fund small startups and cash in on their eventual success, litigation finance can turn a small investment into a super-sized payday.

In Colibri's case, the Fixer funded a top-notch legal team, handled the grueling three-year patent-infringement lawsuit... and, in 2023, left the mega medical-device company with egg (and ham) on its face.

At the end of a seven-day trial, a jury found Medtronic guilty of patent infringement and ordered it to pay Colibri \$106.5 million in damages. That's peanuts to Medtronic, of course... but to the little Colorado research company, it was huge.

Way to bring home the bacon.

Of course, the Fixer has far bigger cuts of meat to fry. In 2015, the firm purchased the legal claims to sue a South American country for the improper nationalization of an oil company in 2012. It spent \$16 million acquiring a portion of claims, plus another \$50 million waging a long legal battle on behalf of its clients.

In 2023, a U.S. federal judge awarded \$16 *billion* in damages for the case, which remains ongoing. We estimate the company could ultimately receive \$2 billion to \$3 billion for its share of these damages.

The best part: the Fixer is valued at just \$3.3 billion today. And the potential multibillion-dollar windfall represents just one winning ticket within the company's portfolio containing over 800 legal claims. This is the company we are recommending in this issue.

## The Lucrative Business of Lawsuits

The company is **Burford Capital (NYSE: BUR)** – incorporated in 2009, in the Bailiwick of Guernsey, a self-governing jurisdiction of the United Kingdom. Burford's U.S.-based co-founders, Christopher Bogart (CEO) and Jon Molot (CIO), work primarily from New York City and Washington, D.C.

Burford is the world's largest provider of litigation finance, managing a \$7.1 billion portfolio of assets. These assets include a variety of legal claims the company has acquired and agreed to fund. The business is highly profitable and capital efficient. Through the first three quarters of 2023, Burford generated \$794 million in revenue and \$510 million in net income, representing a world-class 64% profit margin.

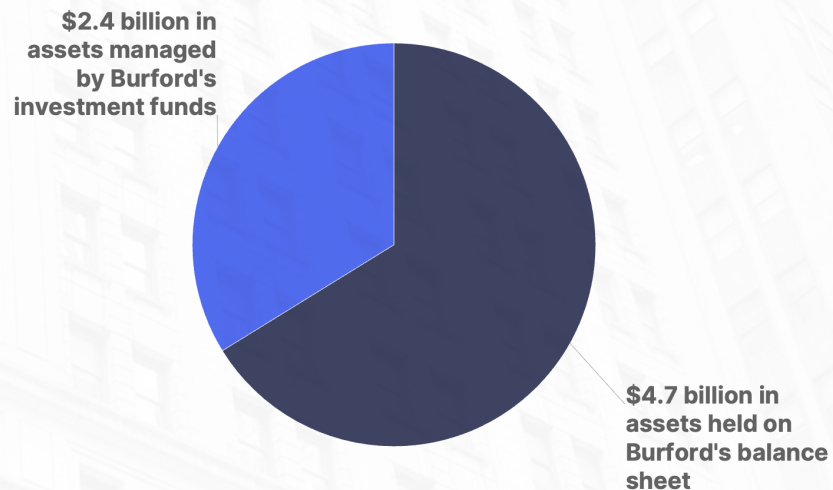
The company provides litigation financing in two ways.

The first is through its own balance sheet, which contains \$4.7 billion in legal assets. These assets include settlements of legal cases that are currently paying out cash that Burford can use to fund future cases. They also include cases still in litigation that have an estimated value that can be used as collateral to borrow funds.

These include cases like a \$140 million portfolio of antitrust claims Burford acquired from global food distributor Sysco in 2023. These lawsuits were filed against a group of meat suppliers – the suits allege that the suppliers conspired to illegally inflate prices over many years. For cases funded through Burford’s balance sheet, the company takes on all of the risk and captures all of the potential upside from capital invested in pursuing legal claims.

Burford also finances litigation through an asset-management business, which manages \$2.4 billion across nine private funds. Following this path, Burford allocates investor capital into the same types of cases it funds through its own balance sheet. The difference is that the investors take on all of the risk, and Burford captures a smaller portion of the upside. On this capital managed for investors, the company earns management fees and a percentage of the returns generated – typically a 2% annual fee on assets, plus 20% of profits.

### Burford's Asset Management by Segment (2023)



Source: Bloomberg | Data as of Q3 2023

Burford benefits from this dual-pronged, capital-allocation approach in two ways. First, it allows the firm to manage its risk more effectively when tackling large cases. Some of Burford’s biggest clients bring a portfolio of cases – like the group of antitrust lawsuits mentioned earlier that Sysco filed against its meat suppliers – that can require hundreds of millions of dollars in funding for research, pre-trial maneuvering, and ushering each case through the legal system. Instead of putting all of its own money at stake, Burford can share a portion of the risk with the investors in its managed funds.

This risk transfer – and larger capital pool – in turn allows Burford to take on cases that many of its smaller competitors can't invest in. Burford's primary competition comes from small to mid-sized hedge funds, as well as several publicly traded asset-management firms. The largest of these competitors, Australia-based Omni Bridgeway, has \$1.7 billion of balance-sheet capacity and generated \$56 million in earnings last year, or roughly one-tenth of what Burford generated.

Next, let's examine the value Burford provides for the clients it partners with in pursuing litigation.

### **Capturing Upside by Limiting Downside for Law Firms**

Burford primarily deals in legal cases for corporations, and avoids pursuing litigation claims involving individuals (like personal-injury cases, for example).

It pursues these claims through one of two pathways.

**1.** Burford partners with a law firm that has an existing arrangement with a corporate client to pursue a legal claim on a contingency basis. Contingency means the law firm doesn't get paid unless it wins.

For law firms, contingency cases can create substantial cash-flow challenges and financial risks. These firms must pay their high-priced lawyers and overhead costs out of their own pockets – potentially for years before resolving a case – prior to receiving payment. And if the litigation attempt fails, they aren't paid.

Most law firms are privately held, with limited access to outside capital. Thus, they often don't have the funds or risk tolerance to pursue large contingency cases that require millions of dollars up front. Burford can address this capital need and shoulder the risk burden, in exchange for getting a substantial cut of the future awards from litigation – which is typically around 50% of the proceeds from successful case resolutions.

**2.** Burford also assumes the funding for legal claims from corporations directly. In these cases, Burford provides the capital for a third-party law firm to pursue litigation in exchange for a share of any potential payout. In certain cases, Burford also pays a one-time upfront fee that allows corporations to immediately get paid for their legal claim. In exchange, Burford will take an even larger percentage of the future payout (up to 100% in some cases).

These corporate clients range in size and sector – from small private manufacturing firms to \$50 billion publicly listed food conglomerates.

On one end of the spectrum are businesses that can't afford the cost of litigation – like Colibri Heart Valve, which we mentioned earlier, or, say, a cash-strapped technology startup defending against intellectual-property infringement from a competitor. Or a small manufacturing company that was forced into bankruptcy due to faulty equipment from a vendor. These companies have potentially valuable legal claims but little or no cash to pursue them.

On the other end of the spectrum are larger, publicly traded corporations that have the funds to pursue legal action, but whose stakeholders might consider it a poor use of capital. The investors, analysts, and corporate boards of these companies might frown upon seeing cash flow diverted to legal expenses – and for good reason.

In fact, a public company's share price can suffer as earnings sink from the expense of a years-long legal battle. Meanwhile, the market typically won't assign any value to a potential future payout, nor will it even price into a stock the positive impact from a one-time legal victory. Thus for many corporate managers, putting money behind litigation is all downside and little upside.

Burford solves this problem by taking on all of the risk and all the financing needs of litigation. Plus, the upfront fee – a guaranteed cash payment – provides an added incentive for corporations. Instead of getting penalized for diverting resources toward costly litigation with an unknown outcome, Burford enables corporations to immediately get paid for what can be a hidden asset on their balance sheet.

Thus, Burford acts as both a capital provider and a risk reducer for law firms and corporations. In exchange, both parties are happy to surrender a significant portion of the potential upside to Burford.

Burford manages the risk it incurs from funding these claims through several mechanisms. As mentioned earlier, the company transfers a portion of cases to investors, through its asset-management arm. This allows the company to spread its exposure across a highly diversified portfolio of hundreds of lawsuits. It also manages risk through rigorous due diligence, drawing upon its hundreds of successfully completed cases to accurately estimate the timeline, costs, and potential rewards of litigation. And it only selects a minority of cases that meet a high threshold of prospective returns.

This allows Burford to minimize the impact of the inevitable losses. Meanwhile, its diversified portfolio provides many shots on goal to capture the outsized winners.

The end result is a lopsided risk/return proposition, with limited down risk and substantial upside.

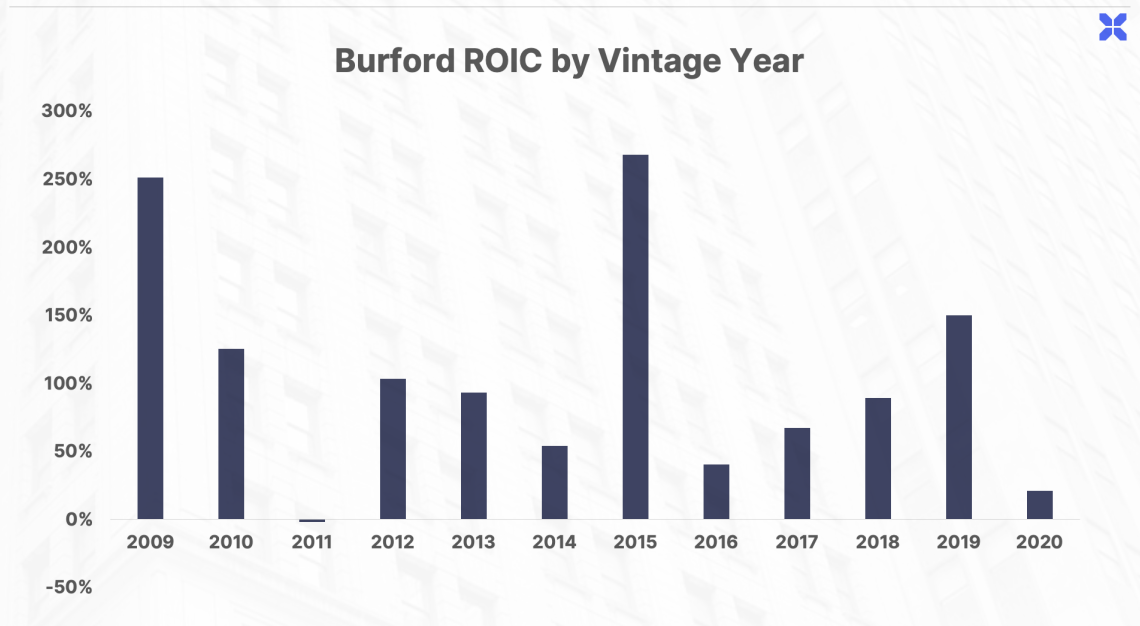


## Burford’s Asymmetry: High Returns, Limited Risk

Since its inception, Burford has earned profits on 84% of the total capital deployed. For the 16% of capital deployed that resulted in losses, Burford recovered 32% of the invested capital. The majority of its capital (58%) has generated returns ranging from 0% to 99%. On 12% of deployed capital, Burford has earned returns between 100% and 199%. And on 14% of its capital, the returns have exceeded 200%.

Importantly, these returns aren’t the result of a one-off outlier success. The company has delivered the same “win big, lose small” return profile consistently throughout its history.

The table below shows a comprehensive list of Burford’s return on invested capital (“ROIC”) earned from concluded cases for each year of its history (referred to as “vintage year” returns) through 2020. Because less than 5% of cases initiated after 2020 have been resolved, we exclude the 2021-2023 vintage years – Burford’s average time of litigation across its portfolio is 2.5 years.



Across all vintage years, through 2020, Burford has achieved an average of 105% ROIC since inception. The only losing year was in 2011, when it generated a loss of 2% ROIC. This shows that Burford consistently generates outsized returns, while keeping downside limited.

Next, let’s dive deeper into Burford’s investment process to see how it achieves these results.

## Carefully Calculating Returns

As with any successful investment approach, Burford’s search for legal assets begins by turning over a lot of rocks. The company analyzes 1,000 to 1,500 cases each year, ultimately selecting 4% to 8% of the most compelling opportunities.

The company performs both legal and financial due diligence on each potential case. The key factors at play include the estimated odds of successful litigation, the potential payout, and the expected time and expense of pursuing each case. Burford requires its team of legal and financial analysts to submit lengthy written arguments on the merits of each opportunity to an investment committee. It also uses proprietary software that draws upon data from prior cases to help inform the outlook for future cases.

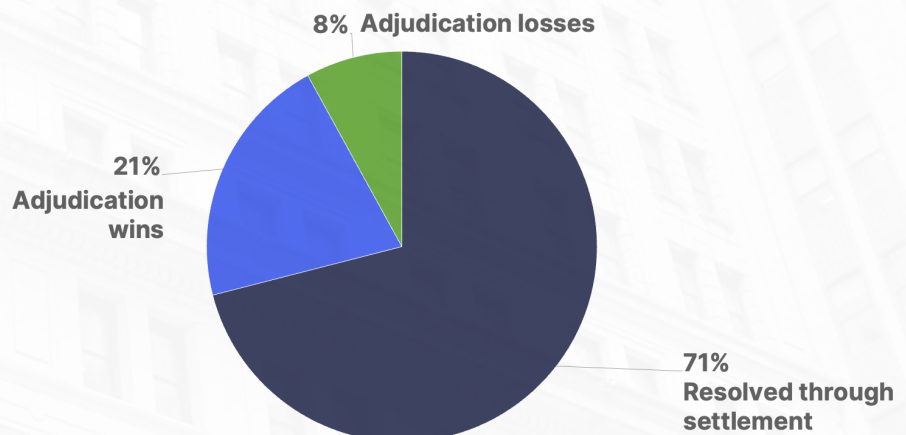
Burford’s investment committee makes the final decision on whether to proceed with a case, as well as the terms of the proposed payment structure it will submit to clients. The payment structure can vary significantly from case to case, but Burford aims to achieve a return on capital of 80% to 90%. It also calculates an internal rate of return (“IRR”) target, which factors in a discount rate and the anticipated time between outlying capital and receiving cash back. The company targets IRRs in the mid-20% to low-30% range.

The same due diligence and return thresholds apply regardless of whether funding comes from Burford’s balance sheet or through its asset management arm.

When Burford and its client agree to proceed with a legal claim, a case typically resolves in one of three ways: settlement before it reaches adjudication, when a judge or jury issues a ruling; a win from adjudication; or a loss from adjudication.

Since Burford’s inception, the company has resolved 71% of cases through settlement, 21% from adjudication wins, and 8% through adjudication losses.

**Burford Case Outcomes Since 2009**



Source: Company filings

In cases that resolve through settlement, the litigation will proceed through a series of preliminary legal steps like discovery, depositions, and pre-trial hearings. But before reaching the final stage of argument before a judge or jury, the opposing parties chose to end litigation for a mutually agreed upon monetary award.

Settlements generally result in smaller rewards than cases won through adjudication. But they also come with several advantages, including: 1) fewer legal expenses devoted to the case, 2) removal of any risk associated with going to trial, where the case can be lost, and 3) a shorter time frame between deploying capital and earning a return.

Since Burford's inception in 2009, the company has deployed \$937 million into cases that ultimately settled. It received a total of \$1.5 billion in rewards from these cases, translating into a 60% ROIC. The average litigation time for these settled cases is 2.2 years, delivering a 22% IRR.

Adjudicated cases required \$392 million of the capital Burford has deployed since inception, or 30% of the total. These cases proceed through all litigation steps to a final trial or arbitration hearing, resulting in either a win or loss. In the event of a loss, Burford typically loses 100% of the capital invested. In some losing cases, the deal terms allow Burford to earn a nominal recovery of capital from its clients.

Since Burford's inception, \$278 million of the \$392 million allocated toward adjudicated cases have resulted in a win. These investments have generated total cash proceeds of \$965 million, or a 247% ROIC. The average litigation time is 2.9 years, translating into a 49% IRR.

The remaining \$114 million in cases resolved through adjudication have resulted in a loss. Burford ultimately recovered \$18 million in cash, or a -84% ROIC.

Across its entire portfolio of completed cases, Burford has deployed \$1.3 billion and received cash proceeds of \$2.5 billion since inception – \$1.2 billion over and above what it invested. This translates into a comprehensive ROIC of 87% and a 27% IRR.

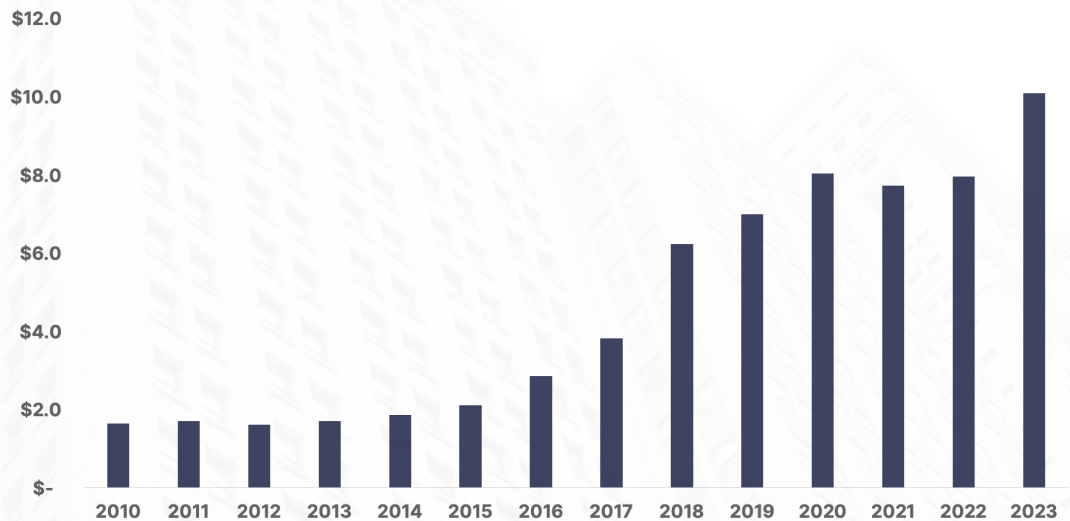
The IRR is a useful metric because it indicates the rate at which Burford can compound capital.

If Burford could immediately recycle every dollar earned into new cases, a 27% IRR would translate into 27% compounded growth in capital. However, as with any investment process, there's a time lag between generating returns and finding the next opportunity for capital deployment.

Since its inception, Burford has done an excellent job recycling capital into new opportunities and increasing its asset value. This shows up in the company's rapid growth in book value – the total value of its assets, net of liabilities. Burford's book value has increased from \$1.60 per share in 2010 (its first full year in business) to \$10.10 per share by Q3 2023. That works out to a compounded annual growth rate of 15%.



## Burford's Book Value per Share



### Recession-Proof, But Not Pandemic-Proof

One of the attractive features of Burford's business model is that it's not correlated to overall economic growth or financial market volatility. The primary driver of Burford's book value and earnings growth is the ability to deploy capital into legal cases, and push those cases through the legal system. Since the number of legal cases it can invest in does not rise or fall with the overall economy, this makes Burford the ultimate recession-proof business model.

But the last few years have shown that Burford is not pandemic proof. When the COVID-19 lockdowns struck, court systems around the world ground to a halt. Many were shut down completely, while others operated at a fraction of their normal capacity due to social distancing and other health precautions.

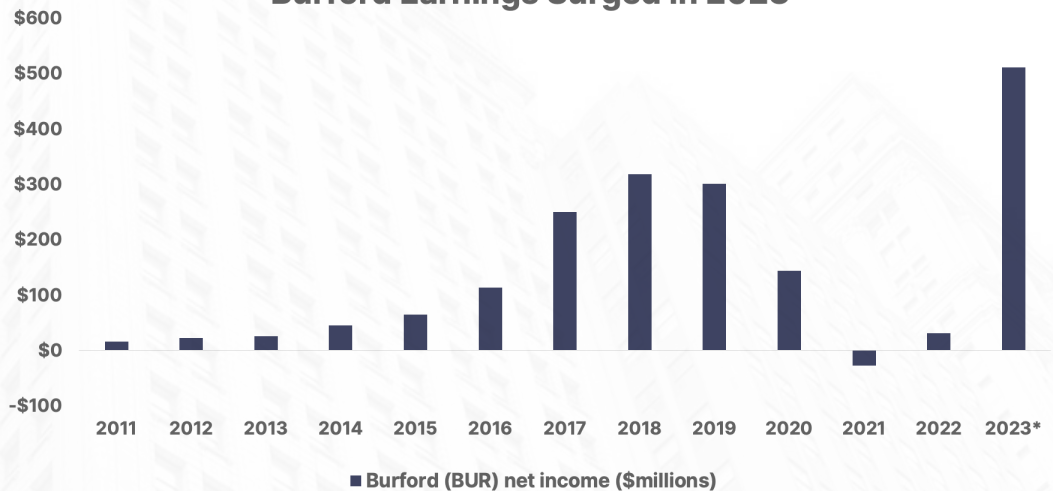
This caused a sharp drop off in the amount of capital Burford could put to work, which fell by nearly 50% from \$481 million in 2019 to \$257 million in 2020.

But even after courts gradually reopened, litigation progress was slow, plagued by a long backlog of cases. As a result, Burford's earnings fell from \$301 million in 2019 to a loss of \$27 million in 2021.

As the courts began clearing their backlogs, Burford's earnings moved into positive territory by 2022. In the first three quarters of 2023, earnings surged to a new all-time high of \$510 million (Q4 and full year 2023 results will be reported on March 12):



### Burford Earnings Surged in 2023



Source: Company filings | \*Figure includes revenue for the first nine months of 2023

Absent the one-time loss from a global pandemic, Burford has been consistently profitable since 2011, when its first cases originated in 2009 and 2010 began to be resolved. Since then, the company’s net income has grown more than 30-fold, from \$15 million in 2011 to \$500 million in the first three quarters of 2023.

Burford has achieved this impressive growth while maintaining a conservative balance sheet, measured by its favorably low debt-to-asset ratio. Since inception, Burford has kept its debt-to-asset ratio below 50%, meaning it has less debt than assets:



### Burford Debt/Assets Ratio



## Culture, Leadership, and Litigators

Burford's conservative approach to the business is a reflection of its culture, and of the fact that the insiders benefit personally if the company succeeds. Every employee owns shares of Burford stock, including its two co-founders who each own roughly 4% of the company. As a whole, insiders at Burford own 10% of the business, collectively making them the company's largest shareholder.

In a [2021 interview](#), Burford co-founder and CEO Christopher Bogart explains how this heavy insider ownership translates into a culture focused on steady, profitable growth, while maintaining a conservative leverage profile:

*"We're employee owners of this business. We use a conservative leverage structure. We insist that the business be profitable. And we invest only moderately in growth, instead of explosively."*

Burford's leadership is a critical part of the company's success to date.

Bogart and fellow co-founder, CIO Jon Molot, are both titans of the legal profession, with long track records of success before launching the company.

Bogart earned his law degree from top-rated Western University in Ontario, Canada. He began his career as an investment banker for JPMorgan Chase, focusing on bankruptcy workouts. In the late 1990s, he became general counsel of Time Warner. At just 34 years of age, he managed one of the largest legal teams in the world, overseeing a team of more than 350 lawyers. He then served as CEO of Time Warner Ventures, a \$9 billion division focused on investments and acquisitions of new digital technologies.

From there, he moved further into the investment field as the managing director of Glenavy Capital, where he made venture capital ("VC") investments. He also oversaw the Glenavy Arbitration Investment Fund, an early pioneer in litigation financing, in the early 2000s.

At the time, litigation financing was a niche of the investment world, relegated to small private hedge funds. But over time, Bogart saw that litigation finance had several key advantages over the VC world. It generated the same lopsided risk/reward proposition, but with substantially shorter holding periods – two to three years versus five or more for VC investments.

Meanwhile, VC investments typically require a bull market for an exit event – where a private company is either sold or taken public through an initial public offering ("IPO"). Litigation finance, on the other hand, only relied on progress through the legal system – which occurs regardless of whether financial markets go boom or bust.

Bogart (pictured, right, below) saw the opportunity to extricate the legal finance industry out of the private fund world into a separate business, operating as a public company. In 2009, Bogart brought John Molot in to help launch Burford as the company's chief investment officer.



Molot (above, left) graduated at the top of his class at Harvard Law School. In addition to his work at Burford, he teaches at Georgetown Law School in Washington, D.C. Molot is widely cited on litigation finance in academic law journals.

Before co-founding Burford, Molot advised hedge funds and investment banks on litigation risk during mergers, acquisitions, and private equity deals. He also served as a senior advisor to the Treasury Department during the Obama administration.

Among his many achievements at Burford, Molot was the architect of a landmark U.S. case that resulted in a \$16.1 billion judgment against the country of Argentina, and one that could add billions of dollars in shareholder value to Burford.

## How Burford Could Turn \$66 Million Into \$3 Billion

The case in question stems from the government of Argentina's 2012 nationalization of YPF SA, one of the country's largest oil companies. One clause in YPF's bylaws required that the government offer to purchase the outstanding shares from U.S. investors in the event of a nationalization. When Argentine authorities failed to make this offer, it effectively wiped out the existing shareholders.

At the time of the nationalization, YPF was listed on the New York Stock Exchange. This gave YPF investors the right to pursue litigation against the Argentine government in the Southern District of New York ("SDNY") – part of the U.S. federal court system.

Two of YPF's largest shareholders were investment funds Petersen Energía Inversora and Eton Park Capital Management, which together owned more than 25% of the company's shares. Petersen ultimately went bankrupt due to the loss from its YPF investment. Both companies filed suit against Argentina for breach of contract.

In 2015, Burford paid \$16 million to Petersen and Eton Park to acquire a share of their litigation claims against Argentina. It also agreed to fund the litigation, which would total around \$50 million. In exchange, Burford would receive 35% of any proceeds awarded to Petersen and 73% awarded to Eton Park.

In March 2023, SDNY presiding Judge Loretta Preska ruled that the Argentine government was at fault for failing to offer to purchase the YPF shares owned by Eton Park and Petersen. On September 28, the court ruled that the government owed damages of \$14.4 billion to Petersen and \$1.7 billion to Eton Park.

This \$16.1 billion ruling represents the single largest judgment awarded against a foreign country in the history of the U.S. legal system. In total, Burford's share of the judgment equates to \$6.2 billion.

While these rulings are a major win for Burford, it's not yet a complete victory. First, the Argentine government will have the opportunity to appeal the case. If the appeals fail and the government is stuck with the judgment, there's also the challenge of collecting the money. Argentina has defaulted on its debts three times in the last 25 years, driven by the mismanagement of its economy and finances. Last year, the inflation rate exceeded 200%, and the company has few foreign reserves.

Most likely, Burford will need to cut a deal with Argentine authorities and accept a discount. And it will likely also need to stretch any payments out over several years, or possibly more. In which case, the payment could be feasible, even for Argentina.

Analysts from investment bank Jefferies estimate Burford will ultimately recover around \$3 billion of the \$6.2 billion judgment – roughly \$13.70 per share. For a frame of reference, Burford's entire business trades for less than \$15 per share today.

In other words, the market has assigned very low odds that Burford will collect even 50 cents on the dollar of the YPF judgment. While we agree that investors shouldn't bank on this outcome, it does represent a source of massive upside potential that's not currently priced into the shares.

Even in the worst-case scenario where Burford collects nothing from YPF, the case has already been a huge win. That's because, in order to reduce its risk, Burford already secured a triple-digit return from selling a portion of its YPF stake to other hedge funds for \$236 million. So no matter what happens from here, Burford is playing with house money on YPF.

Though it's an unusually large potential payout, the YPF case highlights a key aspect of Burford's business – volatility is a feature and not an aberration.



## Big Upside Comes With Big Volatility

Burford's business model is based on its willingness to assume the risks that its clients can't or don't want to bear in pursuing legal claims. Burford charges a healthy premium for taking on these risks, and over the long run, it consistently generates high returns. Along the way, the company will incur its share of volatility from the inevitable cases that don't pan out.

As a result, the company's earnings profile is highly erratic – with big quarterly swings between outsized profits and large losses. Investors should not view Burford as a normal operating business that produces reliable earnings, as the company noted in its 2019 annual report:

*"Burford is not a business for those focused on short-term profits or for those who eschew volatility and seek predictability. Quarterly earnings are both irrelevant to understanding the value of our business and outside our control. We finance large, complex commercial claims. Our cash flows come from their resolution. There is no 'normal' for such claims; they are inherently idiosyncratic. We have had cases resolve in less than a week, and we have matters from 2010 still going strong. That is the opportunity in our business, and it is why we are able to generate the returns we have historically delivered. If litigation were predictable as to outcome and duration, banks could finance it; there would be no need for Burford."*

For investors who can look past short-term earnings and share-price volatility, the opportunity is vast.

## The Dominant Leader in a Large, Fast-Growing Market

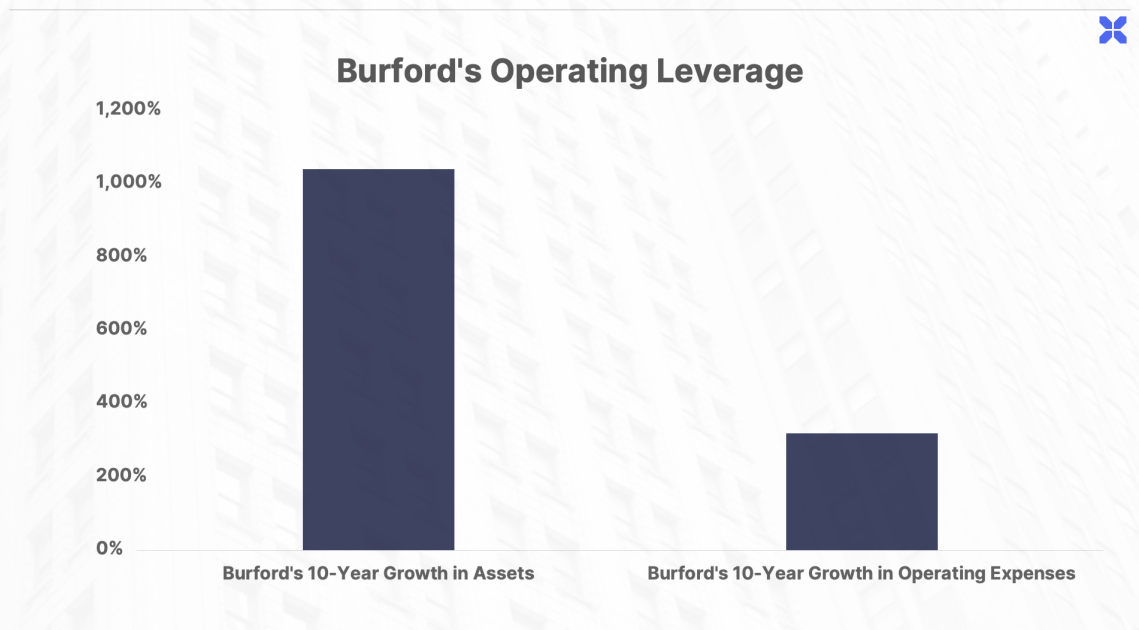
Litigation finance is still in its infancy. Burford is the largest player by a wide margin, and yet its \$7.1 billion portfolio of assets represents a small fraction of the total addressable market. Each year, \$1 trillion is spent pursuing litigation, and a substantial portion of this spending goes to contingency-based cases that Burford could take on.

The scope of opportunity among its corporate clients could be even larger. Today, there's an unquantifiable amount of potential legal assets sitting idle on corporate balance sheets going unmonetized – mainly because of the risk and cost involved in chasing the claims. Burford's research indicates that a majority of corporations have claims worth \$20 million or more that have not yet been pursued.

A decade ago, most corporate executives didn't realize companies like Burford existed. But that's begun to change. Burford has brought greater awareness to the industry through its success in high-profile cases, like the YPF deal, which generated headlines across the financial and business media. With awareness growing, the number of legal claims Burford sources directly from corporations has grown more than 10-fold over the last decade, and now represents half of its total business.

These corporate clients allow Burford to put more capital to work at a time, with some clients offering deals with dozens of related claims in one case. When Burford first started out and dealt exclusively with law firms, the average case size was less than \$10 million. Today, it has single corporate clients with case sizes exceeding \$300 million.

Undertaking larger corporate cases has allowed Burford to gain tremendous operating leverage. The same lawyers and financial experts that once litigated \$10 million cases can now tackle \$100 million cases. As a result, over the last 10 years, Burford’s asset size has grown at nearly three times the rate as its operating expenses:



This is contributing to Burford’s expanding profit margins, which came in at a record 63% for the first three quarters of 2023. Meanwhile, as Burford grows larger, it’s also creating a powerful competitive advantage over its peers.

### Brand Power, Scale, and Data Create the Ultimate Competitive Edge

Over the last three years, Burford has grown its total portfolio more than 50% per year. Its total balance-sheet capacity of \$8 billion exceeds that of its next closest competitor by more than four-fold. This means Burford can take on larger cases that its smaller competitors can’t afford to touch. Its dominant size also means clients can have faith in Burford’s access to its own funds or those of its investors to make good on its promises to back their litigation claims.

Plus, as Burford logs more wins, it's establishing a track record of success and wider brand-name recognition. Burford counts 94% of the top 100 law firms in the U.S. as previous clients. And in a survey among lawyers, 86% of respondents identified Burford as either the leading or the only litigation financier by name.

Finally, Burford's biggest competitive advantage lies in its unmatched data set for underwriting deals, and one that its competitors can't replicate.

Recall that Burford settles roughly 70% of its cases. This is common throughout the industry, as most legal cases end in settlement. In jurisdictions like the Southern District of New York, for example, 90% of cases end in settlement. By law, most of these settlements are confidential.

This means that the payouts resulting from these settlements remain sealed. Estimating the payoff is a critical part of the underwriting process. Because Burford has been involved in so many settled cases over the last 14 years, it has insights into both the payoff and costs involved that few others do. Burford feeds this information into its proprietary modeling software, which helps it make competitively priced offers to clients, while ensuring it is properly compensated for the risks incurred.

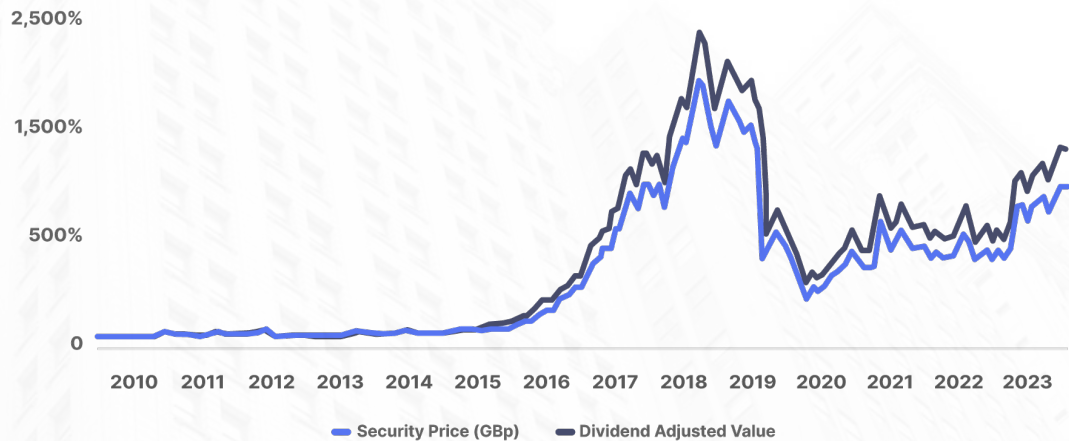
Any new entrants hoping to compete for cases in jurisdictions like SDNY are forced to underwrite business without knowing 90% of the outcomes. Poor underwriting ultimately means either taking on too much risk, or setting the wrong price.

Burford's brand power, scale, and its data insights are all structural advantages that become more powerful as the company grows larger and completes more cases. It's also bringing more awareness to the industry, helping unlock the potential of the overall market. That gives us confidence that the company can continue delivering world-class returns and maintain high rates of growth.

Since first going public on the London Stock Exchange in October 2009, Burford has generated a total return of 1,383%, or a compounded annual gain of 21%.



## Burford's High Rates of Return



Source: Bloomberg

This chart shows Burford’s trading history on the London Stock Exchange, which began in 2009. Burford also began trading on the NYSE in 2020 – listed on both exchanges under the ticker symbol BUR.

Burford’s dominant industry position, competitive advantages, and large addressable market indicate a long runway ahead for profitable growth. The company’s heavy insider ownership and conservative culture also gives us confidence that management will act as responsible stewards of shareholder capital.

And with the business generating over \$500 million in annual profits, we’re getting in at an attractive price of less than 7x earnings.

**Action to Take: Buy Burford Capital (NYSE: BUR) up to \$20 per share.**

Note: the inherent volatility of Burford’s quarterly earnings will also translate into substantial share-price fluctuations. We recommend investors use prudent position sizing in order to limit the impact of this volatility on their portfolios. We’re assigning a risk rating of 4, and we’ll place Burford Capital in the “Exponential Growth” portion of the tracking portfolio.

## New to the Porter & Co. Portfolio? Start With Our Top 3 “Best Buys” Today

Our goal at Porter & Co. is to bring you world-class investment research, focused on “inevitable” businesses that you can buy and hold forever. This is the surest and safest path to building permanent wealth.

While we don’t believe in timing the market, we do keep a constant eye out for bargains. In each edition of *The Big Secret*, we highlight three current portfolio picks that are at an attractive buy point. In addition to today’s recommendation, we suggest you focus on these:

1. Howard Marks is the Warren Buffett of debt. [Oaktree Specialty Lending Corporation \(Nasdaq: OCSL\)](#) is a subsidiary of Marks’ Oaktree Capital Management and is capitalizing on higher yielding private loans. OCSL makes primarily floating-rate loans to private middle-market companies. Because private companies aren’t required to report the same level of disclosure as public companies, they are considered higher risk, and must pay higher rates to issue debt. OCSL’s expertise in analyzing the risks of these private companies gives them an opportunity to capitalize on higher yields from these private market loans. The weighted-average yield on OCSL’s debt portfolio is 12.2%, which the company returns to shareholders through an enticing 11.2% dividend. Best of all, OCSL offers a chance to capitalize on what’s likely to be an explosion in the opportunity set for distressed-debt when today’s credit cycle turns. Investors would also benefit if the economy remains strong and rates stay higher for longer, since 84% of OCSL loans are issued at floating rates.
2. [Franco-Nevada \(NYSE: FNV\)](#) – the “Gold Digger” That Gets Paid to Do Nothing – is the leading gold royalty company. Franco-Nevada provides financing for mining companies to do the capital-intensive work of pulling rocks out of the ground, in exchange for a percentage of the mine’s output. As a result, Franco-Nevada is highly capital efficient, generating 58% free cash flow (“FCF”) margins. Its world-class management team has established one of the best track records in the industry. FNV shares have sold off since October, when the Panamanian government shut down a large copper mine that is one of the company’s largest royalty assets. The decline is overdone as the market capitalization of FNV has fallen by \$6 billion while the mine is worth roughly \$5 billion, effectively pricing in a total loss of the mine. Meanwhile, with gold prices approaching record highs above \$2,000 per ounce, the rest of FNV’s portfolio is firing on all cylinders. As a result, the shares trade near their lowest valuation on record. (We provided more details of the latest developments in a recent [Portfolio Update](#).)

**3. Philip Morris (NYSE: PM)** owns the international rights to Marlboro, the world's leading traditional tobacco brand. Over the last decade, the company has invested heavily in less-harmful alternatives to traditional tobacco products. These investments have made Philip Morris the global leader in less-harmful nicotine consumption, including its hit IQOS and ZYN brands. Unlike most traditional tobacco companies suffering from declining sales, Philip Morris' smoke-free business is delivering double-digit revenue and earnings growth. The company is incredibly capital efficient, with 20% ROE and 40% returns on invested capital. It's also a recession-proof business, and trades at an attractive valuation of just 14x earnings, with a 5.8% dividend yield.

## Portfolio Update

The Big Secret on Wall Street PORTFOLIO										
ENERGY & COMMODITIES	Ticker	Description	Purchase Date	Cost Basis	Closing Price	Yield	Income Received	Total Return	Status	Risk Rating (1 - 5)
EQT CORPORATION	EQT	U.S. Gas-Focused E&P	06-02-2022	\$48.87	\$34.75	1.29%	\$0.91	-27.04%	Buy Under \$50	4
VIPER ENERGY	VNOM	Oil and Gas Royalty	09-01-2022	\$29.68	\$31.72	7.19%	\$2.24	14.42%	Buy Under \$34	3
BWX TECHNOLOGIES, INC.	BWXT	Nuclear Power Equipment	12-22-2022	\$58.05	\$83.84	1.10%	\$0.92	46.01%	Buy Under \$80	3
BLACK STONE MINERALS	BSM	Oil and Gas Royalty	02-16-2023	\$15.90	\$16.02	11.86%	\$0.95	6.73%	Buy Under \$18	2
BITCOIN	BTCCUSD	Cryptocurrency	05-11-2023	\$27,011.85	\$45,488.60	0.00%	\$0.00	68.40%	Buy Under \$50,000	4
PEABODY ENERGY	BTU	Coal Mining	06-22-2023	\$21.29	\$25.98	1.15%	\$0.15	22.73%	Buy Under \$25	4
CNX RESOURCES	CNX	U.S. Gas-Focused E&P	09-28-2023	\$22.82	\$20.20	0.00%	\$0.00	-11.48%	Buy Under \$30	3
<b>BATTLESHIP STOCKS</b>										
CREDIT ACCEPTANCE CORP	CACC	Consumer Finance	07-28-2022	\$560.28	\$555.93	0.00%	\$0.00	-0.78%	Buy Under \$600	3
NOVO NORDISK	NVO	Pharmaceuticals	10-27-2022	\$53.30	\$118.39	0.53%	\$0.74	123.50%	Hold	2
WINMARK CORPORATION	WINA	Specialty Apparel Stores	09-15-2022	\$217.60	\$377.38	0.85%	\$16.20	80.87%	Hold	1
FRANCO-NEVADA CORP	FNV	Precious Metals Streamer	05-11-2023	\$154.77	\$108.50	1.25%	\$1.02	-29.24%	Buy Under \$125	2
PAYPAL	PYPL	Payment Processor	07-20-2023	\$73.02	\$56.13	0.00%	\$0.00	-23.13%	Hold / Stop Loss at \$50	3
<b>FOREVER STOCKS</b>										
PHILIP MORRIS	PM	Tobacco Maker	07-14-2022	\$89.62	\$89.01	5.84%	\$7.68	7.89%	Buy Under \$105	1
DOMINO'S PIZZAS INC	DPZ	Restaurants	02-27-2023	\$300.00	\$426.58	1.03%	\$3.63	43.40%	Hold	3
DEERE & COMPANY	DE	Agricultural Machinery	08-31-2023	\$410.94	\$385.83	1.52%	\$2.82	-5.42%	Buy Under \$450	3
DIAGEO PLC	DEO	Alcoholic Beverages	12-14-2023	\$145.72	\$147.73	3.40%	\$0.00	1.38%	Buy Under \$160	3
<b>INCOME &amp; DISTRESSED DEBT</b>										
SABA CAPITAL INCOME & OPPORTUNITIES FUND	BRW	High Yield Bond Fund	03-16-2023	\$8.01	\$7.39	13.80%	\$0.97	4.37%	Buy Under \$9	3
OAKTREE SPECIALTY LENDING CORP	OCSL	Specialty Investments	03-30-2023	\$18.57	\$19.68	11.18%	\$1.72	15.24%	Buy Under \$22	2
<b>PROPERTY &amp; CASUALTY INSURANCE</b>										
W.R. BERKLEY	WRB	P&C Insurance	05-25-2023	\$56.10	\$79.88	0.50%	\$1.22	44.56%	Buy Under \$62	2
PROGRESSIVE CORPORATION	PGR	P&C Insurance	06-08-2023	\$131.08	\$182.96	0.22%	\$0.30	39.81%	Buy Under \$160	2
CHUBB LIMITED	CB	P&C Insurance	06-08-2023	\$191.60	\$244.34	0.16%	\$2.58	28.87%	Buy Under \$220	2
SKYWARD SPECIALTY	SKWD	P&C Insurance	06-16-2023	\$24.66	\$30.01	0.00%	\$0.00	21.70%	Buy Under \$35	2
<b>EXPONENTIAL GROWTH</b>										
TELLURIAN INC.	TELL	U.S. LNG Exporter	06-16-2022	\$3.82	\$0.55	0.00%	\$0.00	-85.60%	Hold	5
EVOLUTION AB	EVVTY	Casinos & Gaming	11-30-2023	\$103.77	\$122.95	1.76%	\$0.00	18.48%	Buy Under \$130	4
INMODE	INMD	Medical Devices	01-11-2024	\$20.19	\$25.36	0.00%	\$0.00	25.61%	Buy Under \$25	5
BURFORD CAPITAL	BUR	Litigation Finance	02-08-2024	\$14.37	\$14.37	0.87%	\$0.00	0.00%	Buy Under \$20	4
<b>BETTER THAN THE MARKET</b>										
CAMBRIA SHAREHOLDER YIELD	SYLD	Yield Focused ETF	01-05-2023	\$59.67	\$67.32	2.30%	\$1.17	14.78%	Buy Under \$65	2
<b>WATCHLIST</b>										
SHERWIN-WILLIAMS	SHW	Specialty Chemicals	NA	-	\$312.15	3.10%	-	-	Buy Under \$150	
ULTA BEAUTY	ULTA	Specialty Retail	NA	-	\$519.12	0.00%	-	-	Buy Under \$350	
NIKE	NKE	Athletic Footwear & Apparel	NA	-	\$103.77	0.00%	-	-	Buy Under \$75	
HOME DEPOT	HD	Home Products Stores	NA	-	\$363.72	2.30%	-	-	Buy Under \$240	
PAYCOM SOFTWARE	PAYC	Application Software	NA	-	\$195.75	0.77%	-	-	Buy Under \$150	

Disclaimer: this hypothetical portfolio should not be considered investment advice or a recommendation to buy/sell any financial instrument. For informational purposes only, investors should perform their own due diligence before buying or selling any financial instrument. No express or implied guarantee of accuracy or applicability to real-world trading. Risk Ratings are based on a security's fundamentals and business model rather than its current valuation. Cost basis refers to the closing price the day before a security is recommended.

CLOSED POSITIONS	Ticker	Description	Purchase Date	Cost Basis	Sell Price	Yield	Income Received	Total Return	Status	
HOVNANIAN ENTERPRISES	HOV	Homebuilder	06-30-2022	\$42.79	\$36.50	0.00%	\$0.00	-14.70%	Sold Sept. 29, 2023	
ACTIVISION BLIZZARD	ATVI	Video Games	03-02-2023	\$77.71	\$90.99	0.00%	\$0.00	17.09%	Sold July 11, 2023	
AMERIGO RESOURCES	ARREF	Base Metals	03-30-2023	\$1.21	\$0.91	8.84%	\$0.04	-21.90%	Sold Oct. 12, 2023	
DREAM FINDERS HOMES, INC.	DFH	Homebuilder	04-27-2023	\$14.89	\$20.69	0.00%	\$0.00	38.95%	Sold Oct. 12, 2023	
QURATE RETAIL, INC.	QRTEP	8% Cumulative Preferred Stock	01-19-2023	\$40.64	\$29.28	27.32%	\$6.00	-13.19%	Sold Oct. 12, 2023	
ANNALY CAPITAL MANAGEMENT	NLY	Real Estate Investment Trust	02-02-2023	\$24.12	\$17.78	19.80%	\$1.30	-20.90%	Sold Oct. 12, 2023	
MICROSTRATEGY INC	CUSIP: 594972AC5	2025 Convertible Bond	10-13-2022	\$758.00	\$1,371.14	0.55%	\$7.50	81.88%	Sold Nov. 9, 2023	
ALTRIA	MO	Tobacco Maker	07-14-2022	\$41.63	\$42.03	9.33%	\$4.74	12.35%	Sold Nov. 30, 2023	
<b>HALL OF SHAME</b>										
ICAHN ENTERPRISES	IEP	Specialty Investments	12-08-2022	\$50.65	\$20.63	38.78%	\$4.00	-51.37%	Sold May 25, 2023	
ALTSOURCE ASSET MANAGEMENT	AAMC	Asset Management	07-06-2023	\$58.00	\$10.02	0.00%	\$0.00	-82.72%	Sold Aug. 17, 2023	

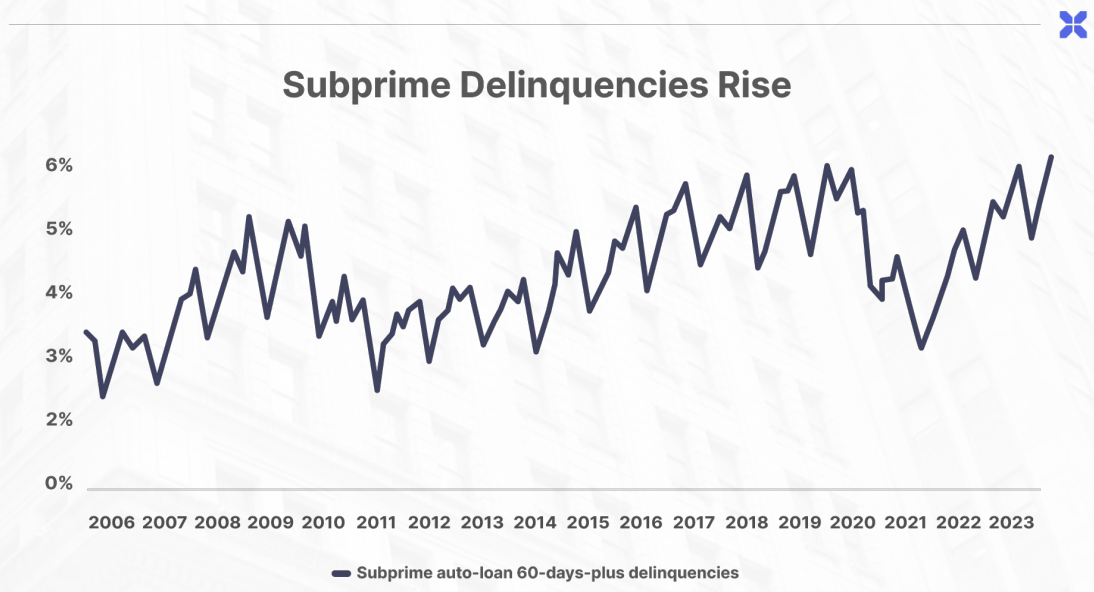
## This Subprime Lender Shows Resilience

**Credit Acceptance (Nasdaq: CACC)** continues posting strong loan growth and taking market share as the subprime auto-loan-industry flounders melts down.

Since reporting Q4 2023 earnings on January 31, CACC has risen 3% on strong loan-volume growth of 26.7%. Revenue increased 1% in Q4, bringing 2023 revenue to \$1.64 billion while earnings per share (“EPS”) declined 14% to \$10.06 compared to last year. Lower-than-forecast collection rates for loans assigned in 2021 and 2022 drove down net cash flows by \$57 million – a modest 0.6% decrease from the prior year. But 2023 loans are performing better than those assigned in 2021 and 2022, and market conditions favor the company.

Credit Acceptance’s capital efficiency business practice converts 74% of revenue to free cash flow (“FCF”) and consistently produces earnings regardless of the market cycle. The company returns this cash to shareholders through share buybacks – including more than 100,000 shares repurchased in Q4, out of 12.8 million total outstanding (down 46% over the last 10 years).

We warned of the prospect of rising delinquencies in our Credit Acceptance [recommendation in July 2022](#). Since then, subprime-auto-loan delinquencies nationally have soared from just under 4% to more than 6% today, higher than the peak defaults level reached during the Great Financial Crisis.



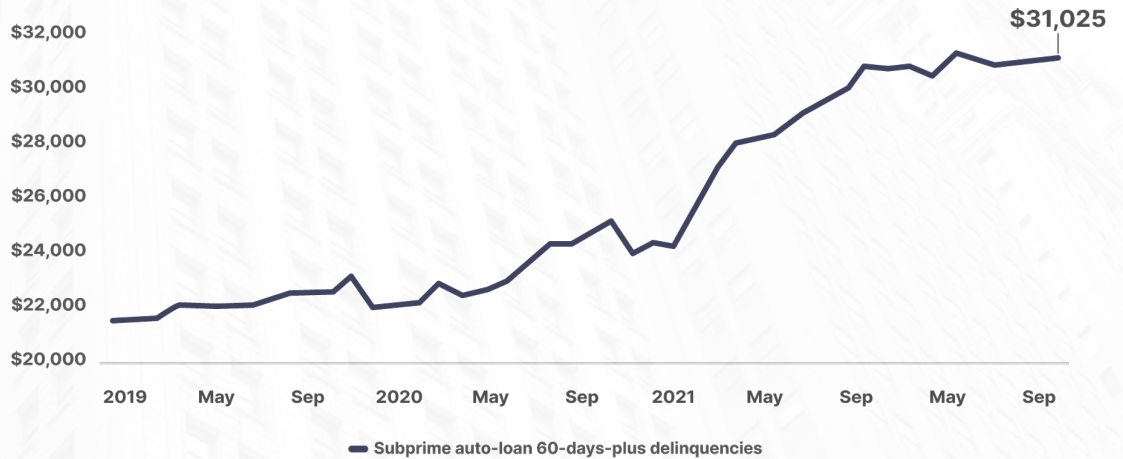
Source: Fitch Ratings ABS Index

The rise in delinquencies and unfavorable conditions caused many subprime auto lenders to exit the market, as we [pointed out last summer](#) – allowing Credit Acceptance to gain market share.

From 2020 to 2022, numerous factors following the COVID shutdown combined to increase used-car prices: the federal government's injection of massive stimulus into the economy, student-loan deferments, and supply-chain disruptions among them.



### Used Vehicle Average Sale Price

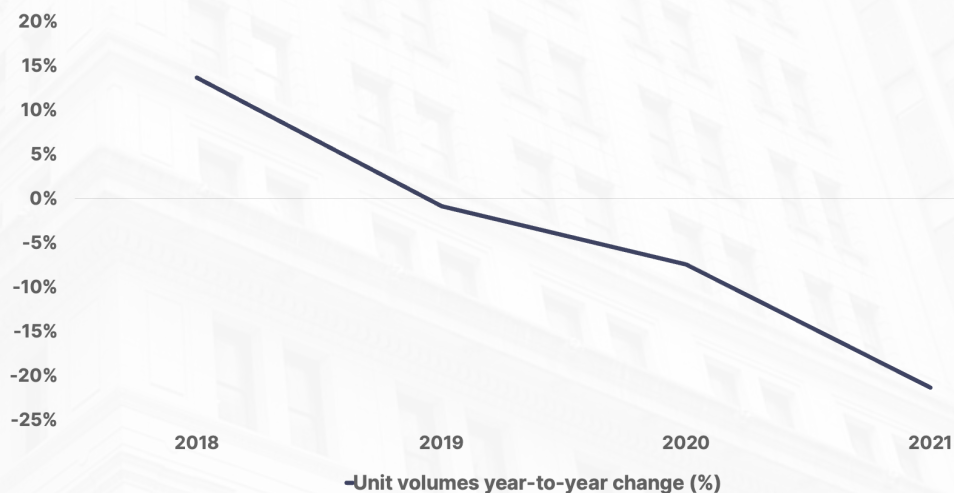


Source: J.D. Power PIN

Used-car prices skyrocketed and the subprime-auto-lending market boomed while interest rates were at record lows. Low rates forced subprime auto lenders and Credit Acceptance to offer more competitive loans than before. Credit Acceptance was more conservative than others in extending new loans. As a result, its loan volume declined 7.5% and 21.4%, respectively, in 2020 and 2021.



### CACC's Loan Volumes Decline During Lending Booms





As we highlighted in our recommendation in July 2022:

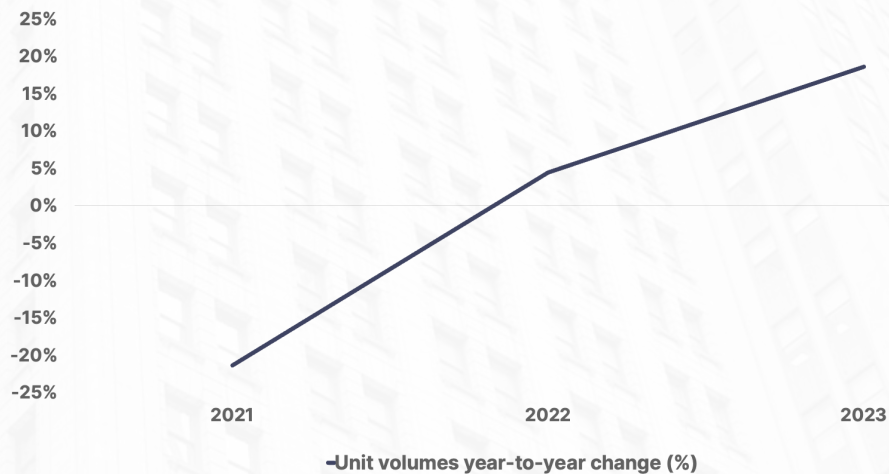
*“If anything, the unique bull market environment of the past two years has been the equivalent of a recession for Credit Acceptance.”*

During upcycles, when the subprime lending market heats up, Credit Acceptance takes a conservative position. But when the down cycle begins and competition deteriorates, the company becomes more aggressive in extending loans, resulting in market share gains.

Indeed, in 2023 the competition left the market and Credit Acceptance increased market share. Its loan volume grew 18.6% in 2023. The company’s strong loan-volume growth suggests it is now capitalizing on favorable market conditions.



### CACC's Loan Volumes Surge During Lending Crunches



Not only is Credit Acceptance increasing loan volumes, but it’s also making more money on each loan. We can see this in the spread (or difference) between the value recovered from each loan compared to the projected recovery at the time of issuing the loan. Credit Acceptance’s spread increased to 21.7% in Q4 2023 compared to 19.4% in Q4 2021, meaning that it receives a higher percentage of net cash flows for loans issued in Q4 2023 compared to two years before. Lower spreads during 2021 and 2022 influenced the company’s conservative nature in extending fewer loans. Now, with fewer competitors in the subprime lending market, Credit Acceptance is more selective in approving loans while expecting to earn a higher percentage of net cash flows compared to two years ago.

Credit Acceptance’s differentiated lending model factors in a significant margin of safety into each loan so that even if a loan’s performance is worse than expected, the company is still likely to earn significant profits.

Credit Acceptance has been profitable every year since 2002. We expect the company to continue to generate earnings and capture greater market share as loan volume rebounds, just as it did during the previous subprime lending bust from 2007 to 2009.

We continue to recommend buying Credit Acceptance (Nasdaq: CACC) below \$600 per share.

### Novo Nordisk Flourishes on Robust Demand for Weight-Loss Drugs

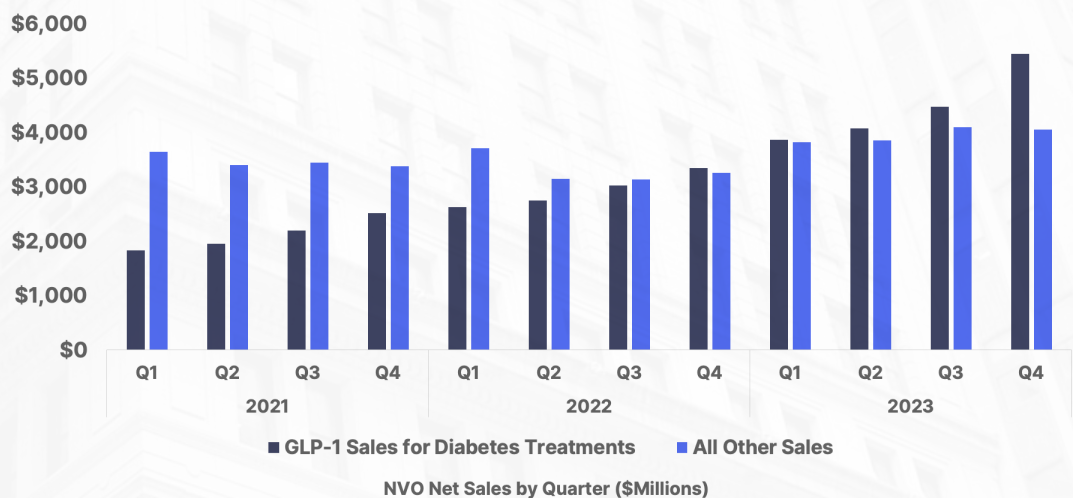
Shares of **Novo Nordisk (NYSE: NVO)** continue making new record highs as the GLP-1 boom accelerates. Ravenous demand for the blockbuster weight-loss and diabetes drug drove a 51% increase in GLP-1 sales in Q4 2023. Novo is well on track to grow its prized GLP-1 segment through 2030 as demand for weight-loss drugs continues to outpace supply.

Globally, around 3 billion people were obese in 2023, and around 50% of Americans are considered overweight. The obesity public-health crisis is not going away, and safe GLP-1 weight-loss treatments – like Ozempic and Wegovy – are beginning to play a prominent role. JP Morgan estimates that the size of the GLP-1 market will exceed \$100 billion in sales by 2030, compared to \$13.4 billion in 2022.

Sales of Novo’s GLP-1 treatment for diabetics increased 393% in the U.S in Q4.

The surge in demand for these drugs is showing up in Novo Nordisk’s financials. Revenue increased 37% and EPS rose 63% in Q4 2023.

### Novo Nordisk’s Obesity Drug Business Is Booming



Wegovy and Ozempic generated \$18.4 billion in sales in 2023 – 55% of Novo’s revenue, up from 37% in 2022. Novo will continue to roll out GLP-1 treatments in the U.S. by doubling the production of Wegovy. Recall, Wegovy is the weaker dose strength of Novo’s GLP-1 treatments versus the stronger-dose Ozempic, which is for diabetes patients.

Novo is maximizing the sales of Wegovy, while it aggressively expands its production capabilities. And it’s paying off. Novo’s return on invested capital was 67% in 2023 – higher than its five-year average of 62%. That means for each \$1 invested, Novo earned \$0.67 in profits.

Novo's investments into GLP-1 capacity will continue driving revenue and earnings for years to come.

The company announced on February 5 that as part of its holding companies acquisition of Catalent (NYSE: CTLT), it plans to buy three manufacturing plants from this third-party manufacturer of Wegovy. The plants will come online in 2026 and gradually increase production to help Novo meet long-term demand for GLP-1 treatments. The move to acquire the Catalent plants also gives Novo Nordisk greater control and visibility into its production – avoiding supply-chain constraints that it experienced in 2022 due to two plant shutdowns for failed inspections.

Meanwhile, Novo continues to lobby for Food and Drug Administration (“FDA”) approval of Wegovy for **cardiovascular diseases**. A recent medical study found that the drug reduces the risk of heart attacks and strokes by 20% amongst the obese population. If the FDA were to approve Wegovy for these types of treatments, it opens the door for expanded insurance coverage that could lower costs to patients and make GLP-1s more accessible for millions of new patients.

We reiterate that Novo Nordisk (NYSE: NVO) is a hold.

### Minor Turbulence Makes OCSL More Compelling

Shares of **Oaktree Specialty Lending (Nasdaq: OCSL)** declined 7% after reporting lower-than-expected net investment income due to an increase in non-accruals (a loan that is no longer collecting interest because a payment is overdue by 90 days or more). We believe the market has overreacted. **Since recommending Oaktree Specialty Lending in March 2023**, shares have risen 15%, and the recent decline in the price presents a compelling buying opportunity.

Oaktree Specialty Lending is a subsidiary of Oaktree Capital Management (OCM), founded by distressed-investing legend Howard Marks in 1995. The world’s largest high-yield-debt investment firm, the parent company has grown from \$5 billion in assets under management to \$190 billion today.

Oaktree Specialty Lending mainly offers loans to private companies with enterprise values between \$100 million and \$750 million. It's more difficult for lenders to get the same level of financial information from private companies as they would from a public company – as a result, private companies pay higher rates on debt. Given Oaktree's expertise in analyzing distressed credit, it is able to generate higher yields from private market loans.

Here is a look at the four companies in Oaktree Specialty Lending's portfolio that dragged down its overall performance:

- Thrasio, an Amazon Marketplace aggregator that capitalized on e-commerce trends during the pandemic, is struggling to keep up with loan payments as sales lag due to supply-chain delays and reduced Amazon traffic to its sites. Oaktree Specialty Lending is working with management to develop a new payment plan – exploring a restructuring.
- OTG Management owns and operates restaurants and designs airport terminals throughout North America. Oaktree Specialty Lending invested alongside Oaktree's flagship Opportunities Fund during the pandemic travel slowdown. OTG's performance has remained steady but higher interest rates are now deflating free cash flow. Oaktree Capital and several other investors acquired OTG, and Oaktree Specialty Lending is confident the business will recover.
- Impel Pharmaceuticals is a commercial pharmaceutical company that develops central-nervous-system drugs. Sales of its key product slowed, causing it to enter bankruptcy protection in December. The company is looking for a buyer as it seeks to exit bankruptcy. Oaktree Specialty Lending will have more to share on the recovery of this company as the sales process proceeds.
- Singer, the world's largest consumer sewing-machine company, is facing a post-pandemic slow down after seeing an increase in demand from 2020 to 2022. The lead sponsor of its lending (a non-bank lender that provides credit to a business on behalf of several private equity firms) has injected new capital and Oaktree is working with other lenders on a solution. The company has not missed an interest payment but based on the market price of its securities, Oaktree Specialty Lending cautiously moved the investment to non-accrual.

Oaktree Specialty Lending looks to create a new path for these companies to meet their debt obligations whether through restructuring or a sale. The non-accruals during Q4 represented 4.2% of Oaktree Specialty Lending's debt portfolio – up from 1.8% from the prior quarter. The non-accruals resulted in OCSL's net asset value ("NAV") declining 2.5% to \$19.14 per share versus \$19.63 the previous year. While OCSL's credit quality disappointed investors, the company's net investment income of \$0.57 per share, still covered its \$0.55 dividend.

Something to note: The company's loans have high interest rates due to lending to riskier borrowers deemed less creditworthy. These high rates provide an attractive income stream that helps Oaktree Specialty Lending offset the occasional losses. While non-accruals may continue to rise, given Oaktree Specialty Lending's expertise, we are confident the company can restructure these loans to create the best recoveries for shareholders.

With these four non-accruals making up a small portion of Oaktree Specialty Lending's portfolio of 143 companies, the rest of its portfolio is in solid shape.

At the end of Q4, the company had \$908 million available in credit and \$112 million in cash, giving it more than \$1 billion to invest. Meanwhile, more than 30% of the company's portfolio turned over – meaning that nearly a third of the portfolio was purchased over the past 16 months. By turning over a third of the portfolio, it is strengthening its investment composition to be in sync with current market conditions.

Oaktree Specialty Lending invested \$368 million during Q4, exceeding exits of \$214 million. Its portfolio currently has a weighted-average yield (which is the income it receives from its portfolio) of 12.2%. The majority of its portfolio (78%) is in first-lien loans. These debts sit at the top of the capital stack, and thus get paid first in case of bankruptcy. Meanwhile, 84% of the portfolio was issued at floating rates, positioning itself to generate higher income from today's still elevated interest rate environment.

Oaktree Specialty Lending currently pays out an attractive 11.2% dividend compared to its 7.4% dividend two years ago. It's trading at a slight premium of \$19.43 per share, compared to its NAV of \$19.14, down from \$19.63 on September 30, 2023. Since we believe this drop is an overreaction to the performance of the four portfolio companies mentioned above, it presents investors another buying opportunity. In addition, the company offers a chance to capitalize on the explosion of distressed-debt opportunities when the credit cycle turns.

**Action to Take: Buy Oaktree Specialty Lending (Nasdaq: OCSL) under \$22 per share.**

**Note:** We are removing three stocks from *The Big Secret on Wall Street* watchlist. They are the copper producers **Freeport-McMoRan (NYSE: FCX)** and **Southern Copper (NYSE: SCCO)** as well as homebuilder **NVR (NYSE: NVR)**.

## Mailbag

In *The Big Secret on Wall Street* mailbag, Porter answers letters from readers. He cannot offer individual investment advice, but can respond to general questions.

Please email us at [mailbag@porterandcompanyresearch.com](mailto:mailbag@porterandcompanyresearch.com) to have your questions answered. We'd love to hear from you!

Today's letter comes from J.S. who writes:

"I recently upgraded my subscription to become a paid member. The main reason why I did that was because I was very impressed with Porter's presentations on insurance and the **Gods of Gas (NYSE: EQT)**. As a result I moved a lot of my portfolio into Chubb, Progressive, and EQT. I did this before Porter's talks about the end of America as we know it and how Biden is purposely trying to destroy America. Now I read how Biden is putting the clamps on natural-gas exporting. Porter said he thought promoting natural gas would win the election for Biden in a landslide. As I'm sure you can tell, I am very worried since I have a third of my portfolio in EQT. Has Porter & Co. revised its recommendation on EQT? Thanks."

**Porter's comment:** *Thank you for the question, and for becoming a subscriber.*

*I recently had a lengthy discussion with Doomberg, one of the brightest minds covering energy markets today, on our latest **Black Label podcast episode**. We discussed how the Biden administration's "temporary" halt of LNG-export-license approvals is a short-sighted political gambit aimed at suppressing domestic energy prices ahead of the upcoming presidential election.*

*This latest move on pausing LNG permit approvals follows the Biden administration's previous draining of the strategic petroleum reserve ("SPR"). While this kept oil prices in check, America's SPR inventories now hover near the lowest levels of the last 40 years. This has left the country more vulnerable than ever to a disruption in global oil supplies, just in time for an escalating series of conflicts in the Middle East. This includes the recent attacks on shipping vessels in the Red Sea, which facilitates 7 million barrels per day of global oil flows. What could possibly go wrong?*

*Sadly, our political class shows no hesitancy in manufacturing short-term electoral wins, even if it comes at the expense of mortgaging the country's future.*

*In the long run, America's LNG export industry is one of the country's greatest assets. It will create untold billions of dollars in wealth and secure U.S. energy independence for decades to come. It's also an incredibly geostrategic asset that's helping Europe wean itself off Russian gas. For these reasons, it's my belief that cooler heads will prevail once the election passes.*

*In the short term, U.S. gas prices and thus the shares of the gas producers in our portfolio could struggle.*

*Domestic gas prices were already under pressure from a one-two punch of operational delays from ExxonMobil's Golden Pass LNG terminal, amplified by unseasonably warm winter weather. In early December, ExxonMobil announced that the anticipated start up of the \$10 billion Golden Pass facility was delayed from late 2024 until the first half of 2025. Removing this source of demand from the 2024 supply/demand equation threatens to keep the market oversupplied this year.*

*Meanwhile, the key heating month of December delivered record warmth across much of the U.S., with temperatures 10 to 20 degrees above normal across large swaths of the country. This caused U.S. gas inventories to build to their highest seasonal level in over five years by late January – even before the pause on new LNG permits from the White House.*

*Add it all up, and the near-term outlook for U.S. gas prices will remain challenged. However, this doesn't change our overall thesis on EQT and the other gas-focused companies in our portfolio. We're making a 10-year outlook that America's cheap shale gas will eventually find its way to energy-starved countries around the world.*

*But the one thing I will recommend is to never, under any circumstances, allocate one-third of a portfolio into an industry that's as volatile and unpredictable as natural gas. They call it the "widow-maker" commodity for good reason. I would suggest putting no more than 5% of your portfolio into any single recommendation, and even less for a natural-gas producer.*

*In our next issue, we plan on providing a detailed update on EQT after it reports earnings on Tuesday, February 13.*

*Thank you for your letter.*



A handwritten signature in black ink that reads "Porter Stansberry".

Porter & Co.  
Stevenson, MD

P.S. If you'd like to learn more about the Porter & Co. team, you can get acquainted with us [here](#). You can follow me (Porter) on X here: [@porterstansb](#)